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HOUSE RESEARCH ORGANIZATION

daily floor report

Tuesday, April 07, 2015
84th Legislature, Number 44
The House convenes at 10 a.m.

Two bills and one joint resolution have been set on the daily calendar for second-reading consideration today:

HJR 8 by Otto	Dedicating funds in excess of ESF cap to retiring state debt early	1
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Alma Allen
Chairman
84(R) - 44

SUBJECT: Dedicating funds in excess of ESF cap to retiring state debt early

COMMITTEE: Appropriations — favorable, without amendment

VOTE: 21 ayes — Otto, Sylvester Turner, Ashby, Bell, G. Bonnen, Capriglione, Giddings, Gonzales, Howard, Hughes, Koop, Longoria, Miles, R. Miller, Muñoz, Price, Raney, J. Rodriguez, Sheffield, VanDeaver, Walle

0 nays

6 absent — Burkett, S. Davis, Dukes, Márquez, McClendon, Phelan

WITNESSES: *March 18 hearing:*
For — (*Registered, but did not testify:* Dale Craymer, Texas Taxpayers and Research Association)

Against — None

On — (*Registered, but did not testify:* Rob Coleman, Comptroller of Public Accounts)

March 19 hearing:
For — (*Registered, but did not testify:* Dale Craymer, Texas Taxpayers and Research Association)

Against — None

BACKGROUND: Texas Constitution Art. 3, sec. 49-g establishes the Economic Stabilization Fund (ESF), often called the rainy day fund. The fund's balance is expected to reach \$11.1 billion by the end of fiscal 2016-17, absent any appropriations from the fund, according to the comptroller's January 2015 *Biennial Revenue Estimate*.

Sources of funding. Funds in the ESF come from biennium-ending balances in the general revenue fund and from a portion of oil and natural gas production taxes.

Sec. 49-g (b) requires the comptroller to transfer to the ESF one-half of any unencumbered balance remaining in the general revenue fund at the end of a biennium. Only twice has an unexpended balance been transferred to the fund under this provision, once in fiscal 1992 and again in fiscal 2008.

Under sec. 49-g (d) and (e), the comptroller is required to take 75 percent of any oil and natural gas production tax revenue that exceeds the amount collected in 1987 and send half of that amount to the ESF and half to the State Highway Fund. These allocations can be adjusted under certain circumstances. The Legislature, under sec. 49-g (c-2), is required to enact a law creating a procedure for allocating more than one-half of the funds to the ESF. Government Code, sec. 316.092 establishes this procedure by creating a select legislative committee and requiring that it determine a sufficient balance for the ESF for the next biennium. The balance must be an amount the committee estimates will ensure an appropriate amount of revenue in the ESF.

In December 2014, the Joint Select Committee to Study the Balance of the Economic Stabilization Fund determined that \$7 billion was a sufficient minimum balance for the fund. The balance does not restrict appropriations from the fund but does affect the amounts transferred to the general revenue fund and the State Highway Fund.

ESF cap. Texas Constitution, Art. 3, sec. 49-g (g) sets a cap on the amount of money that the ESF can hold. The fund cannot exceed an amount equal to 10 percent of the total amount deposited into general revenue the previous biennium, minus investment income, interest income, and amounts borrowed from special funds. The fund has never reached the cap.

The cap for the current biennium is \$14.1 billion, and the cap is estimated to be \$16.1 billion for fiscal 2016-17 and \$16.7 billion for fiscal 2018-19. Money drawn from the ESF counts toward the state's constitutional spending limit, according to the Legislative Budget Board.

Under sec. 49-g (i), interest due to the ESF that would put the fund over its cap must be deposited in the general revenue fund.

Appropriations from the ESF. Any amount from the fund may be spent for any purpose if approved by at least two-thirds of the members present in each house. Funds also may be spent to cover an unanticipated deficit in a current budget or to offset a decline in revenue for a future budget with approval of at least three-fifths of the members present in each house.

DIGEST: HJR 8 would amend Art. 3, sec. 49-g of the Texas Constitution to require money that the comptroller withholds from the ESF because it would put the fund over its constitutional cap to be deposited in a new general revenue account that could be appropriated only to retire state debt early. This would replace current law that leaves any money exceeding the cap in the general revenue fund. Any interest earnings that would put the ESF over its cap also would be deposited in the new account.

The ballot proposal would be presented to voters at an election on November 3, 2015. The ballot proposal would read: “The constitutional amendment to dedicate certain money to the purpose of retiring state debt early.”

SUPPORTERS SAY: HJR 8 would establish a fiscally responsible use for money that exceeds the cap on the ESF. The ESF never has been close to reaching its cap so the issue of what to do with excess funds generally has not been considered. HJR 8 would dedicate those funds to the early retirement of debt, which would benefit the state by reducing its debt burden and avoiding problems that could arise from allowing these funds to remain available for spending as general revenue.

Although the Legislature could appropriate spillover funds to early debt reduction without HJR 8, the amendment is needed to ensure fiscal discipline on this issue. Texas should not use money saved during good economic times to grow state government or to temporarily fund ongoing expenses, and HJR 8 would remove the temptation to use excess ESF funds for these purposes.

Retiring debt early would be the best use of these funds because reducing the state’s debt burden increases options for spending current revenue and for borrowing in the future. Texas had \$44.3 billion in total debt

outstanding at the end of fiscal 2014, and HJR 8 would apply only to retiring that debt early, not to paying regularly scheduled debt service. Retiring debt early would eliminate the state's long-term commitment to that debt, thereby reducing the ongoing amount of general revenue that must be budgeted for regularly scheduled debt service. This could free up state funds to be used as the Legislature chooses. In addition, retiring debt would increase the state's capacity to borrow again in the future and would be a positive factor for the state's credit position.

Allowing funds that spill over from the ESF cap to remain in general revenue could create problems if the funds were appropriated for ongoing, general state spending because the source of the funds would not be dependable from one biennium to the next. Using such funds for early debt reduction would be appropriate since it would not be a mandatory expenditure and could be made only when funds were available.

HJR 8 would neither reduce the ESF nor divert any money currently earmarked for the ESF. The amendment would apply only to funds above the ESF cap that would be slated to remain in the general revenue fund under current law. If the ESF were at its cap and legislators made an appropriation that dropped its balance below the cap, no funds would go to the new account until the cap was reached again.

The Legislature would retain full control over the spending of funds deposited in the new account under HJR 8. The Bond Review Board, the Texas Public Finance Authority, and other entities could identify debt that might be advantageous for the state to retire early. However, no funds would leave the new account unless appropriated by the Legislature. If the Legislature decided not to make an appropriation from the new fund to retire debt early or if there was no debt advantageous to retire, money would remain in the dedicated account.

Because HJR 8 would constitutionally dedicate funds to early debt retirement, appropriations of the funds would not count toward the state's spending limit, which constrains the use of certain tax revenue not dedicated by the Constitution. This arrangement would be appropriate because retiring debt early is a long-term fiscal strategy that would save the state money, and the spending cap is designed to limit general purpose

spending.

Placing HJR 8 on the November 2015 ballot would allow the voters to determine whether the state should use excess ESF funds for early debt reduction. If HJR 8 were approved in conjunction with HB 8 by Otto, also on today's calendar, a significant amount of money could be available for early debt reduction beginning in fiscal 2018-19. If HB 8 were enacted, the ESF cap would decrease from an estimated \$16.7 billion to \$11.8 billion in fiscal 2018-19, according to the bill's fiscal note. Under the lowered cap, a projected \$538 million would exceed the cap in 2018, making that amount available for debt reduction if HJR 8 were approved.

OPPONENTS
SAY:

By dedicating funds in excess of the ESF cap for one purpose, HJR 8 would reduce the flexibility of lawmakers to direct state appropriations. Current law balances the needs of the state both to save money for the future and to meet other spending priorities. Once enough funds have been saved in the ESF to reach the cap, funds should continue to be available for any purpose, rather than being reserved for just one. The needs of the state change, and tying the use of revenue in excess of the ESF cap to one purpose would reduce the flexibility of lawmakers to meet those needs.

HJR 8 would result in funds being locked away for early debt retirement, even if it were not advantageous to the state to do so. Debt might be unavailable to retire early, interest on the debt could be so low that other uses of the money might be more beneficial to the state, or consistently retiring debt early could factor unfavorably into the way lenders structure the state's debt. Absent HJR 8, the Legislature could consider all factors and state needs in deciding whether funds exceeding the ESF cap should be used to retire debt or for another purpose.

The state could consider other worthy causes if it wants to dedicate funds that are in excess of the ESF cap. Using excess funds to make contributions to the Employees Retirement System, the Teacher Retirement System, or to the Texas Tomorrow Fund would pay down future liabilities of the state. Public education, higher education or taxpayer relief also could be appropriate uses for excess ESF funds.

The spending limit is designed as a check on state spending, and HJR 8

would work counter to this policy by constitutionally dedicating funds and removing them from the spending limit calculation. The Texas budget should be as transparent as possible and should count the spending of general revenue that spills over the cap toward the spending limit. The amendment also would not be in line with responsible budgeting if funds made available by retiring debt early were used to expand government.

NOTES: HJR 8 would have no significant fiscal impact to the state, according to the Legislative Budget Board's (LBB's) fiscal note. The cost to the state for publishing the resolution would be \$118,681. HJR 8 could result in an indeterminate savings of general revenue debt service payments, depending on the type and size of debt retired, according to the LBB.

The companion resolution, SJR 25 by Nelson, has been referred to the Senate Finance Committee.

HJR 137 by Keffer and its companion, SJR 37 by V. Taylor, also would require funds in excess of the ESF cap to be deposited in an account that could be appropriated only for specific purposes. These proposed constitutional amendments would allow appropriations of these funds to the Employees Retirement System, the Teacher Retirement System (TRS), the health plan for retired members of TRS, and the Texas Tomorrow Fund. They also would require that any funds left in the new account at the end of a biennium be transferred to the Permanent School Fund and the Permanent University Fund. HJR 137 has been referred to the House Appropriations Committee and SJR 37 to the Senate Finance Committee.

SUBJECT: Directing federal money currently sent to general revenue to a new fund

COMMITTEE: Appropriations — favorable, without amendment

VOTE: 21 ayes — Otto, Sylvester Turner, Ashby, Bell, G. Bonnen, Capriglione, Giddings, Gonzales, Howard, Hughes, Koop, Longoria, Miles, R. Miller, Muñoz, Price, Raney, J. Rodriguez, Sheffield, VanDeaver, Walle

0 nays

6 absent — Burkett, S. Davis, Dukes, Márquez, McClendon, Phelan

WITNESSES: *March 18 hearing:*
For — Dale Craymer, Texas Taxpayers and Research Association

On — Ursula Parks, Legislative Budget Board; (*Registered, but did not testify*: Rob Coleman, Tom Currah, Comptroller of Public Accounts; Kevin Kavanaugh, Legislative Budget Board)

March 19 hearing:
For — Dale Craymer, Texas Taxpayers and Research Association

On — Ursula Parks, Legislative Budget Board

BACKGROUND: In 1995, the 74th Legislature enacted HB 3050 by Junell, which consolidated certain funds into general revenue. Among those were two welfare-related funds that had received most of the federal money that Texas received. As a result, federal funds that previously were excluded from general revenue now are included.

Art. 3, sec. 49-g of the Texas Constitution, ratified by voters in 1988, created the Economic Stabilization Fund. The fund, also known as the rainy day fund, is capped at 10 percent of general revenue funds deposited during the previous biennium, excluding investment income, interest income, and amounts in general revenue borrowed from special funds.

DIGEST: HB 8 would amend Government Code, ch. 403 to prohibit the comptroller

from depositing federal money received by the state into the general revenue fund and would allow the comptroller to create a special fund to receive federal money and its associated earnings or interest.

The bill also would require the comptroller to ensure that federal money received by the state was used for the purposes for which it was received.

This bill would take effect September 1, 2015.

**SUPPORTERS
SAY:**

HB 8 would improve transparency in the budgeting process and make clearer the amount of money available to be appropriated by the Legislature. It is misleading to label federal money as “general revenue” because those funds are appropriated by the federal government for a specific purpose and are not actually free to be reallocated by the state.

The bill also would restore the original intent of the cap on the Economic Stabilization Fund (ESF). The fund is capped at 10 percent of general revenue from the previous biennium, but the definition of general revenue has broadened since the creation of the ESF in 1988. At that time, most federal money was deposited into individual funds and less than one-tenth of 1 percent was deposited into general revenue. Since the 1995 consolidation, federal money has grown to comprise more than 30 percent of general revenue, creating an unintentional and artificial inflation in the ESF’s cap.

The projected cap of \$16.7 billion in the 2018-19 biennium is excessive. The largest withdrawal from the ESF in a single biennium was only about one-third of the current balance of \$11.1 billion. By excluding federal money from general revenue, this bill would reduce the projected cap to \$11.8 billion, freeing up any funds in excess of that amount for the Legislature to use for budget priorities.

Besides improving transparency in state budgeting, if enacted in conjunction with HJR 8 by Otto (also on today's calendar), this bill could result in a meaningful reduction of state debt. HJR 8 would dedicate funds in excess of the constitutional cap on the ESF for the early retirement of state debt. By lowering the cap, HB 8 could make more funds available

for this purpose.

Even if HJR 8 did not receive voter approval, additional revenue made available by reducing the ESF cap would not necessarily go to additional state spending. For example, it could be used to buy down property taxes or be appropriated by the Legislature to pay down debt early. HB 8 still would be a positive move for transparency and give the Legislature the opportunity of doing something productive with money that likely never would be used if deposited into the ESF.

**OPPONENTS
SAY:**

HB 8 would reduce the amount of money that could be held in the ESF, an important fiscal safety net for the state. Even if the original intent was that the cap be based on a calculation that excluded federal money, the Legislature should be careful to maintain an adequate level of savings to cover any future budget shortfalls.

**OTHER
OPPONENTS
SAY:**

HB 8 could be improved by linking it to voter approval of HJR 8 or another constitutional amendment dedicating the money above the ESF cap to a particular purpose. This would prevent automatic retention of those funds in general revenue where they could be used for additional spending in the event they were not constitutionally dedicated.

NOTES:

The Legislative Budget Board's fiscal note states that the bill would have a positive impact on general revenue related funds of \$420,990,934 through the biennium ending August 31, 2017.

The fiscal note also indicates that health and human services agencies would need to reconfigure their internal accounting system, though a cost could not be estimated.

SUBJECT: Establishing strategic fiscal reviews of state agencies

COMMITTEE: Appropriations — favorable, without amendment

VOTE: 21 ayes — Otto, Sylvester Turner, Ashby, Bell, G. Bonnen, Capriglione, Giddings, Gonzales, Howard, Hughes, Koop, Longoria, Miles, R. Miller, Muñoz, Price, Raney, J. Rodriguez, Sheffield, VanDeaver, Walle

0 nays

6 absent — Burkett, S. Davis, Dukes, Márquez, McClendon, Phelan

WITNESSES: *March 18 hearing, subcommittee on Budget Transparency and Reform:*
For — (*Registered, but did not testify:* Dale Craymer, Texas Taxpayers and Research Association)

Against — None

On — (*Registered, but did not testify:* Rob Coleman, Comptroller of Public Accounts; Ursula Parks, Legislative Budget Board)

March 19 hearing:
For — None

Against — None

On — (*Registered, but did not testify:* Ursula Parks, Legislative Budget Board)

DIGEST: HB 5 would establish strategic fiscal reviews of state agencies. The director of the Legislative Budget Board (LBB) would be required by September 1 of odd-numbered years to recommend to the LBB state agencies to undergo review. The LBB would select the agencies and conduct the strategic fiscal reviews.

By the seventh day after the beginning of a regular legislative session, the LBB would submit to the Legislature reports with the findings of each

strategic fiscal review conducted since the previous session. The strategic fiscal review reports would include:

- a description of the activities assigned to a state agency, a justification for each activity by reference to statutory or other legal authority, and an evaluation of the effectiveness and efficiency of the agency's policies, management, fiscal affairs, and operations related to each activity;
- an estimate of the adverse effects expected if an activity were discontinued, as well as the expenditures required to maintain a minimum level of service or performance as required by statutory or other authority, and the quantity and quality of service needed to maintain that minimum level and the current level of services for each activity;
- a ranking of the agency's activities that illustrates the relative importance of each activity to the agency's overall goals and purposes; and
- recommendations about continued funding for each activity.

State agencies and entities would be required to submit to the LBB any information requested in connection with the reviews. The Legislature would be authorized to consider the strategic fiscal review findings and agencies' compliance with the review as part of the appropriations process.

Until strategic fiscal reviews were completed, all information related to conducting the reviews or preparing the reports would be considered audit working papers and be excepted from disclosure under the Public Information Act.

This bill would take immediate effect if finally passed by a two-thirds record vote of the membership of each house. Otherwise, it would take effect September 1, 2015.

SUPPORTERS
SAY:

HB 5 is needed to institute a formal review of state agencies to determine if they are using their resources appropriately and efficiently and to help the Legislature make strategic budgeting decisions. The bill would codify the strategic fiscal review process that began in August 2014, when the

speaker directed the House Appropriations Committee and the LBB to undertake a new type of fiscal analysis of a select group of agencies and programs. The process proved useful in helping to develop the state budget and should be formalized.

The strategic fiscal review process would provide the Legislature with an additional tool to make budget and policy decisions. Strategic fiscal reviews would look specifically at the mission, expenditures, and operations of state agencies and analyze the use of taxpayer dollars. Descriptions of agencies' activities and the justification for them could help identify mission creep. Ranking agencies' activities by importance could help identify which activities were essential and which could be reduced or eliminated. The reviews would help the Legislature determine the proper level of resources for an agency.

While current practices using performance-based and zero-based budgeting work well, strategic fiscal reviews would provide lawmakers additional clarity and transparency about agencies' budgets and operations. For example, the reviews conducted in the fall of 2014 identified ineffective programs and the use of funds for impermissible purposes.

Strategic fiscal review would provide a type of comprehensive information not obtained in other evaluations of agencies. For example, Sunset reviews examine whether agencies should be continued, and state auditor reports often concentrate on narrow issues or problems at agencies. A strategic fiscal review's detailed information focusing on agencies' activities would fill a gap not met by these evaluations.

HB 5 would allow the LBB to choose agencies for strategic fiscal review, rather than establish a schedule, to ensure the flexibility to conduct reviews when appropriate. For example, an event or new law could mean that the Legislature needs more information about a specific agency to make sound budgeting decisions. Agencies would be chosen for review by the LBB based on the recommendations of the LBB director, but legislators and others also could identify potential entities to examine.

Formalizing strategic fiscal reviews would not burden state agencies. The

18 agencies and entities reviewed prior to the 84th Legislature were able to use their existing resources for the reviews, and this would continue under HB 5. Just as in 2014, the LBB would take into account the demands on state agencies — especially those under Sunset review — and would not order a strategic fiscal review if it would overburden an agency. The review process in the future should be more efficient for agencies because the LBB now has experience conducting the reviews.

**OPPONENTS
SAY:**

HB 5 would be hard to implement because the strategic fiscal review process requires significant time and resources, and many state agencies already are stretched thin. Some state agencies would have difficulty responding to a strategic fiscal review without increased resources.

Agencies also already are subject to numerous other evaluations, such as Sunset reviews, state auditor investigations, and statutorily required reports, and a strategic fiscal review could be burdensome if conducted at the same time as another evaluation. Providing a schedule of strategic fiscal reviews or developing standard criteria for when to conduct a review would help agencies plan and allocate their resources.

NOTES:

The companion bill, SB 53 by Nelson, has been scheduled for a public hearing by the Senate Finance Committee today, April 7.